MINUTES
of the
FOURTH MEETING
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

September 8, 2015
State Capitol, Room 322
Santa Fe

The fourth meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) for the 2015 interim was called to order by Senator Carlos R. Cisneros, chair, on Tuesday, September 8, 2015, at 10:05 a.m. in Room 322 of the State Capitol in Santa Fe.

Present
Sen. Carlos R. Cisneros, Chair
Rep. Jason C. Harper, Vice Chair
Sen. Ted Barela
Sen. Sue Wilson Beffort
Rep. Antonio Maestas
Rep. Rod Montoya
Rep. Debbie A. Rodella
Sen. William E. Sharer
Sen. John Arthur Smith
Rep. James R.J. Strickler
Rep. Jim R. Trujillo
Sen. Peter Wirth

Absent
Rep. David M. Gallegos
Rep. Tim D. Lewis
Sen. Mark Moores
Sen. George K. Munoz
Sen. Clemente Sanchez
Rep. Carl Trujillo

Designees
Rep. Sharon Clahchischilliage
Sen. Lee S. Cotter
Rep. Randal S. Crowder
Rep. Bill McCamley
Sen. Nancy Rodriguez

Rep. David E. Adkins
Sen. William F. Burt
Sen. Jacob R. Candelaria
Rep. Brian Egolf
Rep. Miguel P. Garcia
Rep. Stephanie Garcia Richard
Rep. Bealquin Bill Gomez
Sen. Stuart Ingle
Rep. Conrad James
Sen. Gay G. Kernan
Rep. Stephanie Maez
Rep. Javier Martinez
Rep. Tomás E. Salazar
Sen. John M. Sapien
Rep. Jeff Steinborn
Rep. James G. Townsend
Sen. Pat Woods

Staff
Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
Rebecca Griego, Records Officer, LCS
Tessa Ryan, Staff Attorney, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

<u>Tuesday, September 8</u>

Revenue Forecast

Demesia Padilla, secretary of taxation and revenue, Elisa Walker-Moran, chief economist, Taxation and Revenue Department (TRD), Tom Clifford, secretary of finance and administration, Leila Kleats, chief economist, Department of Finance and Administration (DFA), and Christina Keyes, economist, Legislative Finance Committee (LFC), gave updates as follows on the fiscal year (FY) 2015 revenue forecast. The forecast was made by the Consensus Revenue Estimating Group (CREG), which consists of economists from the TRD, DFA, LFC and Department of Transportation.

TRD report. Secretary Padilla prefaced the TRD presentation by noting that the CREG's forecast has not changed since the group reported on it to the LFC in Taos. She said that revenue associated with the oil and gas industry has been revised downward since February, but gross receipts tax (GRT) revenue is showing strength.

Secretary Padilla highlighted aspects of the TRD's handout, including: sources of general fund revenue; changes to the prior forecast for revenue from those sources, such as the notable increases in personal income tax (PIT) revenues; the stable growth in GRT revenues; the erratic changes in monthly GRT revenues; the consistency in sector-specific sources' proportion of GRT revenues; and the relative inconsistency, but overall growth, in corporate income tax (CIT) revenues. Secretary Padilla discussed a TRD initiative to implement a new, ongoing program to close the gap between taxes owed and taxes paid. It identifies past-due tax liabilities and alerts those who owe taxes of those liabilities. The department, she said, might need an additional appropriation for the program's continuance.

Secretary Padilla identified and elaborated on some salient factors that could affect the forecast, including: the high-wage jobs tax credit; gaming compacts; and unclaimed property. Claims for the credit, for which the TRD strives for consistency in approach, are tapering off. Many cases associated with the credit have been settled. Still, the TRD will pursue in court those cases on which it has a strong stance. Concerning gaming compacts, the establishment by the

Pueblo of Jemez of a casino near Anthony would increase general fund revenues. Lastly, the department is considering promoting legislation that would allow the state to auction off unclaimed property. Currently, it must be held in perpetuity until claimed.

DFA report. Secretary Clifford commented that, though the forecast brings some good news, potential developments in the oil and gas industry and in the stock market cause concern. Overall, the budget is healthy and stable. Despite the state's heavy fiscal reliance on the volatile oil and gas sector and the heavy blow dealt the state by federal sequestration and budget cuts, the state has sustainable growth. It has managed its budget well without raising taxes or cutting budgets mid-year and has maintained a high bond rating.

Ms. Kleats highlighted aspects of the forecast, including the following:

- the United States' economic outlook — the second-quarter gross domestic product (GDP) exceeded expectations; job growth is strong and broad-based; household debt is at an all-time low; and the dollar has appreciated;
- employment in New Mexico — growth, particularly in the education and health care sectors, is pronounced but tempered by some job losses, especially in the mining sector;
- the GRT base — the construction industry has had the highest annual percentage change, while the oil and gas and mining industries have had the lowest;
- the energy market outlook — oil prices are falling because of less Chinese demand but will be buoyed in time by market forces; and consumer and business spending will increase;
- the New Mexico oil and gas outlook — despite oil production having hit a record high in FY 2015, the CREG took a conservative stance in forecasting future production; the group forecasts decreases in oil and gas prices and gas production;
- the general fund revenue outlook — recurring revenue reached a record high in FY 2015; FY 2016 growth is forecast at .3%; and long-term growth is forecast at 4.5%, still below the 5.2% historic average; and
- a general fund overview — FY 2015 balances are at the 10% target level; and FY 2017 "new money" is forecast at $293 million.

Secretary Clifford continued the presentation by highlighting the administration's views on the forecast and certain fiscal policy matters. The forecast contains uncertainty that could result in increased *or* decreased revenues; overall, the balance of risks is prudent. Despite expecting $293 million in new money to materialize, it is also expected that state agency budgets will be tight, particularly considering potential liabilities related to public education funding and Medicaid. Given this, the administration wishes to focus the new spending on measures for economic development, education reform and public safety. Since the state ranks in the middle-to-upper range in comparison with other states in the region for public employee compensation, the administration will not pursue across-the-board pay increases but, rather, those for positions for which recruitment and retention are more difficult. Concerning tax policy, the administration will focus on several economic development strategies, on energy development and on improving highway funding. Concerning capital outlay, the administration wishes to continue to reform the process and notes that Audit Act compliance has improved dramatically. It also notes that a court ruling on prevailing wages for public construction projects, along with other factors, will dilute the state's spending power in that area. Lastly, concerning financial reporting, the second phase of the cash reconciliation process is under way. State agencies' accounts have been reconciled, and the SHARE system has been stabilized.

LFC report. Ms. Keyes highlighted the following aspects of the LFC-produced handout.

- The estimate for FY 2015 revenue is \$6.2 billion, up by \$112 million from the February estimate of that figure.
- Against a backdrop of nationwide post-recession employment recovery, New Mexico employment is 3% below its pre-recession peak. Nevertheless, the state is headed toward recovery.
- The Bureau of Business and Economic Research forecasts the state's job growth rate at 1.4% for each of the years from 2015 through 2017. The state then will return to its pre-recession employment level. That growth will continue.
- The greatest employment gains in the state are in the health care sector, followed by the professional and technical sector and, third, the hospitality and food sector.
- Second-quarter GDP growth was less robust than expected. The potential of the Federal Reserve System to adjust its monetary policy poses a risk to GDP growth.
- By virtue of improved production methods, the volume of oil produced in New Mexico in FY 2015 exceeded the record for that measure set in 1969. The prices in energy markets continue to fall.
- Changes in the energy sector caused a decline in FY 2015 PIT revenue, but PIT revenues are expected to grow in the two fiscal years after that.
- Due in part to the TRD's efforts to improve taxpayer compliance, GRT revenue increased in FY 2015 from the previous year.
- The revenue risk associated with oil prices was revised since that information was presented to the LFC at its meeting in Taos.

<u>Questions and Discussion</u>

On questioning, the presenters and committee members addressed the following topics.

Program to improve tax compliance. A member requested a comparison of the tax amnesty program (proposed in the most recent regular legislative session) with the TRD's current efforts to improve tax compliance. Secretary Padilla agreed to present information about the TRD's active program at a future meeting.

Public employee compensation. A member requested of Secretary Clifford a ranking of New Mexico among states on compensation for certain types of public employees, including teachers, public safety officers and higher education personnel. Secretary Clifford said that he would send staff a corrected version of page 15 of the DFA handout; that page's second table erroneously lists Texas twice.

SHARE system. Secretary Clifford indicated that money is earmarked for the SHARE system upgrade, which will take approximately 18 months to complete. The change will require training for agency staff.

Prevailing wage ruling. Several members expressed concern about the effects of the recent court ruling on the prevailing wage for public construction projects, especially public school construction. Secretary Clifford indicated that the degree of resulting dilution of the state's buying power will vary depending on the project type and union relationship; certain agencies are in the process of projecting the ruling's fiscal implications. He added that the administration is concerned about the issue and is interested in exploring responses to it.

Capital outlay; system reform. Some members stressed the importance of cooperation for more responsible, effective capital outlay spending and the need to finish — or remove the authorization for — idle projects. Secretary Clifford responded that the reasons for projects' standstill vary widely and are sometimes complicated. Members requested reports on: 1) unspent capital outlay appropriations by year for the years 2013 through 2015; 2) each quarter going forward, how much has been spent on, and the progress of, authorized projects; 3) the outstanding balance on and progress of state-sponsored projects; and 4) the projects that have been stalled because of audit noncompliance and detailed reasons for other projects' languishment. In response, a member indicated that the LFC has information on unexpended project balances.

Fiscal policy of the administration. A member argued that public spending, more so than reliance on private-sector growth, has proved effective at lifting societies out of economic slowdowns; an example is the nation's recovery from the Great Depression. The member questioned the wisdom of the administration's approach to fiscal policy, which includes efforts to shrink government spending and maintain high reserve levels. Secretary Clifford noted, in the case of the recovery from the Great Depression, the distinction between the federal government's ability to deficit spend and the state's requirement to balance its budget. The member cited as economic boons the Medicaid expansion, full public-sector employment and public works projects.

Another member commented on the need for balance and moderation in taxation and regulation. The member contended that New Mexico, which could become more economically robust, has too many tax incentives; further, if the state adopted a tax policy that treated taxpayers more uniformly, businesses would still want to do business here. As things stand, the state's overregulation harms small business viability and development.

Renewable energy development. A member expressed interest in extending the renewable energy production tax credit, remarking that businesses want renewable energy options.

Another member commented on the downsides of the increasing preference for development in renewable, rather than traditional-source, energy. The member's points related to that increased preference included: 1) well-paying jobs are being lost, and jobs in the renewable energy field pay less; 2) companies are going out of business; 3) the state should not exceed minimum compliance with federal emissions standards; 4) preserving people's livelihoods is a concern more important and immediate than eliminating the sight pollution associated with traditional-source energy production; 5) reliance on renewable energies poses greater risk of blackouts and brownouts; and 6) energy affordability is important. Secretary Clifford responded by adding that the state relies heavily for its revenue on the oil and gas industry. Policymakers, therefore, should be prudent when it comes to regulation, the economy and state spending.

Revenue forecast. A member expressed skepticism about the CREG's oil price projections, saying that some in the energy industry see them as too optimistic. The member added that it would be preferable for forecasters to be initially more conservative and for revised forecasts to report rises in new-money projections — rather than drops in that measure, as typically reported. Another member remarked on the inherent difficulty in accurately projecting future revenue.

Revenue stabilization. A member commented on the dwindling ability of the oil and gas sector to compensate when the state underestimates the costs of its enacted measures. The state should, therefore, diversify its revenue streams and more accurately estimate the costs of those measures. It should also strive for predictability and stability in its revenues.

Unemployment insurance. A member brought to the committee's attention the rising costs of unemployment insurance to employers, saying that many of the state's industries, such as skiing, farming and film, hire seasonal workers whose unemployment claims contribute substantially to the cost increases. The state, therefore, should concentrate on promoting industries associated with year-round employment.

Updated Fiscal Impact Report on CIT Provisions of House Bill (HB) 641 (2013)

Secretary Padilla, Ms. Walker-Moran and Frank Crociata, director of tax policy, TRD, gave an update as follows on the TRD's revised estimates, originally made in 2013, of the fiscal impact of HB 641's CIT provisions. Secretary Padilla noted that HB 641 contained several components, such as those related to the film credit and hold harmless provisions, outside of the presentation's focus. She also stressed that the bill's enactment made New Mexico more competitive with other states in the region and, according to an Ernst and Young study of states' business friendliness, propelled New Mexico to the top in manufacturing.

CIT revenue forecast for FY 2015. For FY 2015, the CIT was expected to draw $255 million, or 4% of all general fund revenues, into that fund. This figure represents a decline, possibly due to businesses' net operating losses and renewable energy credits. The CIT generally produces volatile revenue streams whose average for the last six years has been about 4% of annual inflows to the general fund. That proportion is approximately equivalent to or lower than the corresponding measure for neighboring states.

Effects of HB 641. The changes effected by HB 641 affect three of the CIT's major components: 1) the tax rate; 2) apportionment for multistate businesses; and 3) the filing method for multistate businesses.

Tax rate change; fiscal impact. A phased-in decrease in the tax rate on income of $500,000 or more began on January 1, 2014. By the end of 2018, taxpayers will pay 5.9% on that income. When fully phased in, the rate change will affect about half of all CIT taxpayers, the higher-income tier, who generate the bulk of the tax's revenue.

The TRD has revised its original CIT rate reduction analysis, which was based on only taxable year (TY) 2010 data. The revision is based on data from TY 2010 through TY 2012, and it includes projections for FY 2018 through FY 2020. For each of the fiscal years originally measured, the revision forecasts lower CIT revenues.

Apportionment change; fiscal impact. Manufacturers may elect to apportion their income using a formula that, over time, relies increasingly on the sales (versus property and payroll) factor. The sales factor weight will incrementally increase to where, by the end of 2018, manufacturer taxpayers may use a single-sales-factor formula for calculating the tax owed to New Mexico. According to reporting by taxpayers of their North American Industry Classification System (NAICS) codes, manufacturer businesses constitute approximately 10% of CIT filers. That taxpayer set generates a relatively high proportion of CIT revenue.

To calculate the single-sales-factor phase-in's projected fiscal impact, the TRD: 1) based its analysis on two additional years' data and on the most recent forecast for CIT revenue; 2) considered that taxpayers whose reported NAICS code suggests an oblique relationship to manufacturing might also qualify for the advantageous apportionment formulas; and 3) in contrast to the original fiscal impact analysis, assumed that all taxpayers eligible to calculate their tax using the advantageous formulas would use them. The revisions to the forecast of the apportionment change's fiscal impact are minor. Because of the relatively high prevalence of manufacturer-business taxpayers, the single-sales-factor phase-in will depress CIT revenue levels. However, the TRD believes that the measure was critical for helping New Mexico remain competitive among states, particularly other southwestern states.

Filing method change; fiscal impact. Beginning in 2014, combined reporting became mandatory for certain retailers that sell goods in a facility bigger than 30,000 square feet. The fiscal impact of this measure is difficult to estimate. In making its calculation, the TRD assumed that all retailers (who represent approximately 6% to 7% of CIT filers and who generate approximately 5% of CIT revenues) meet the criteria for combined reporting. Further, the TRD reviewed several studies, which suggested a wide range of outcomes. The TRD's revised estimate of this measure's effects resembles its original estimate. Its effects are uncertain, however, in part because of the potential for businesses to apportion their losses to New Mexico. In time, the TRD will better know and predict the measure's fiscal impact.

Questions and Discussion

On questioning, the presenters and committee members addressed the following topics.

Effectiveness of rate reduction and single-sales option. A member made the following remarks: HB 641 was promoted as a job creator, but there is no strong evidence that its pro-business measures have improved the economy or created jobs; rather, New Mexico still falls behind other states in those areas. And given that the almost $70 million annual loss from the CIT rate reduction will result in less money available to pay for other programs, it is questionable whether the initiative was in the state's best interest. In the future, before enacting another initiative based on a supply-side, trickle-down theory, policymakers should be confident that the initiative will have its intended result.

Other members expressed support for the business-friendly measures, arguing that they portray the state as a good place to do business. Further, they have produced concrete results: New Mexico was recognized recently as the top state in the region for manufacturer businesses. One member contended that, to be truly competitive with other states, the top CIT rate should be 4.9%. In response, a member suggested that New Mexico need not have the lowest rate, but rather it should avoid being an outlier among states. Several members agreed that eliminating the CIT would be inadvisable because of the subsequent difficulty of reinstating it, should its reinstatement be desired. Lastly, a member remarked that the rate reduction tempers the relative advantage of businesses that pay tax on business income through the PIT, whose top rate is lower than that of the CIT.

Secretary Padilla responded with the following remarks: the TRD's incapacity to do dynamic scoring prevents it from estimating how many jobs have been created as a result of the passage of HB 641, but it is probable that those measures spurred what the secretary reported is recent growth in the manufacturing industry. Moreover, the projected losses in CIT revenues could be attributable to factors unrelated to HB 641's enactment. Meanwhile, the department is striving to adjust its system so that taxpayers must report any change in their NAICS code; that change would allow the department to more accurately prepare fiscal impact reports. A member requested updates on those efforts.

Other aspects of HB 641. A member remarked on the fiscal gap between HB 641's hold harmless measure and the bill's pro-business measures, adding that the hold harmless measure creates financial strain for many local governments and allows increases in certain jurisdictions' GRT rates. Another member countered that even more broad-reaching than that measure are the initial hold harmless provision's statewide effects; the state's scaling back of that provision was, therefore, justifiable. Other members remarked that: 1) the hold harmless measure was not intended to pay for losses from the pro-business CIT measures; rather, the bill contained a series of trade-offs and measures, including some that saved the film industry; 2) imposition of the hold harmless GRT has yielded an unintended windfall for some local governments; and 3) higher GRT rates are problematic. A member requested a fiscal impact report on the HB 641 measure that tightened the definition of "manufacturing consumables".

In response to members' comments, Secretary Padilla pointed out that HB 641's hold harmless measure does not affect smaller local governments and that larger local governments, which are affected, have more opportunity for growth. She agreed to send to staff a report on the hold harmless measure's effects on local governments.

Income Tax Credit for Preservation of Cultural Property — Overview and Proposed Changes

Veronica Gonzales, secretary of cultural affairs, and Wade Jackson, general counsel, Economic Development Department (EDD), presented as follows on the existing preservation of cultural property income tax credit and on proposed changes to it. Secretary Gonzales opened by highlighting the credit's benefits and its potential to enhance cultural and historic preservation and economic development.

Existing credit. Mr. Jackson reviewed the existing tax credit law. At present, a taxpayer may take a PIT or CIT credit for half of the cost, up to $25,000, of the restoration of one or more cultural properties on the historic register. If that property is in an arts and cultural district, the cap is $50,000. A project must comport with preservation goals and receive approval from the Cultural Properties Review Committee to qualify for the credit.

Proposed changes and results. Mr. Jackson continued by reviewing companion bills from the last regular session to amend the tax credit. In addition to imposing an annual aggregate-credit cap of $1.5 million on the credit, HB 583 (2015) and Senate Bill 414 (2015) would have: 1) made properties located in MainStreet districts and frontier communities eligible for the enhanced credit; 2) increased the per-taxpayer credit limit; and 3) made the credit refundable. The bills' first key measure would have boosted in-state and out-of-state tourism and enriched property preservation. The bills' second key measure would have introduced a distinction between residential and commercial properties and assigned new caps to certain types of properties and projects. And the bills' third key measure would have improved the restoration incentive for property owners who are "land rich but cash poor", since those taxpayers tend to have lower tax liabilities. The third measure also would have provided for an income stream while a project is in progress.

Additional points. Mr. Jackson said that with the changes in place: 1) construction activity would increase; 2) efforts to enhance preservation and those to enhance development would be less at odds; and 3) the state would improve its ability to help retail businesses.

Enacting the changes is a priority of the administration. The EDD is soliciting comments and concerns about the tax credit so that they can be addressed before the committee considers the proposal for endorsement. Jeff Pappas, state historic preservation officer and director, Historic Preservation Division, Cultural Affairs Department, who was in the audience, added the following: 1) New Mexico was the first state to enact a historic properties tax credit program — now, 34 states have one; 2) many of those other states' credits are refundable; and 3) the proposed changes to New Mexico's credit would enhance the incentive for restoration of cultural icons in rural and MainStreet communities.

Annual Report — Locomotive Fuel Gross Receipts and Compensating Tax Deductions

Mr. Jackson reported as follows on the deductions from gross receipts and the compensating tax for sales of locomotive fuel.

Scope of the deductions. In the case of the GRT, the deduction is offered on the sale of fuel to a common carrier to be loaded or used in a locomotive engine. In the case of the compensating tax, the deduction is offered on the value of fuel to be loaded or used by a common carrier in a locomotive engine. For both, certain parameters related to capital investment by the common carrier apply.

Use and results of the deductions. Two railroad companies, Union Pacific and BNSF Railway, have qualified for the deductions. Union Pacific's capital investment was $350 million in an intermodal facility. The investment created 1,375 temporary jobs, 436 permanent jobs and more jobs indirectly. Its deduction is worth $15.9 million. BNSF, meanwhile, added 38 jobs in FY 2015 and 86 since the deduction began. BNSF employs 1,211 employees in six locations in the state. It has bought almost $56 million worth of fuel to take advantage of the deduction.

Adjournment

There being no further business before the committee, the RSTP adjourned at 2:30 p.m.